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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 275

PUBLIC COMMON STOCKHOLDERS' PROTECTIVE COMMITTEE OF ARKANSAS NATURAL GAS CORPORATION, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The findings and opinion of the Securities and Exchange Commission, dated October 1, 1952, are not yet officially reported and are set forth in the Commission's Holding Company Act Release No. 11511 (R. 62a).[1] The opinion of the Court of

[1] The symbol "R" refers to petitioner's appendix to its brief in the court below. The Commission's findings and opinion follow page 62a of the record and the district court's opinion follows page 5a, with the original pagination retained in the record filed in this Court. Accordingly, record references to the opinions of the Commission and the district court will be made to pages 62a and 5a, respectively, of the record, followed by the specific page in the opinions.

Appeals for the Third Circuit (R. 67a-68a) is reported at 204 F. 2d 797. The opinion of the district court (R. 5a) is reported at 109 F. Supp. 522.

JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was entered on May 28, 1953 (R. 66a). The petition for a writ of certiorari was filed on August 20, 1953. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Where a plan for the reorganization of a registered holding company, pursuant to Section 11(e) of the Holding Company Act, provided for the *pro rata* distribution of new common stocks and cash to the holders of two classes of stock having equal rights in assets and earnings, and where claims had been asserted against the dominant stockholder of said company by public holders of one of said classes of stock, does a provision in the plan for settlement of said claims through additional cash payments by the dominant stockholder to the public holders of said class of stock render the plan unfair to holders of the other class of stock?

STATUTE INVOLVED

Section 11(e) of the Public Utility Holding Company Act of 1935 (49 Stat. 803, 15 U.S.C. 79k(e) provides in pertinent part:

> In accordance with such rules and regulations or order as the Commission may deem

necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. . . .

STATEMENT

Arkansas Natural Gas Corporation ("Arkansas-Natural"), a registered holding company prior to consummation of the plan herein, is a subsidiary of Cities Service Company ("Cities"), also a registered holding company. Arkansas-Natural owned all of the outstanding common stocks of Arkansas Louisiana Gas Company ("Arkansas-Louisiana"), a gas utility company, and of Arkansas Fuel Oil Company, a non-utility company. Arkansas-Natural had outstanding the following securities: (a)

2,188,000 shares of preferred stock, of which Cities owned about 40%; (b) 4,081,000 shares of common stock, of which Cities owned about 75%; and (c) 3,522,000 shares of Class A common stock, of which about 24% was owned by Cities. The charter rights of the common and the Class A stocks were alike in all respects except that the latter had no voting rights (R. 62a, 3-4).

The Commission and the district court approved a plan for the reorganization of Arkansas-Natural pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935; the Court of Appeals affirmed the District Court order. The plan, which has been substantially consummated, provided for the merger of Arkansas Fuel Oil Company into Arkansas-Natural under the name of Arkansas Fuel Oil Corporation ("Arkansas-Fuel"), and for the distribution of the common stocks of Arkansas-Louisiana and Arkansas-Fuel pro rata to the holders of common and Class A stocks of Arkansas-Natural, including Cities. The plan further provided for a cash payment by Cities of about $4,070,000 to the public holders of the common and Class A stocks of Arkansas-Natural. Of this amount, approximately $805,000, or 25¢ per share, was distributed to the public holders of these stocks in settlement of derivative or corporate claims asserted on behalf of Arkansas-Natural against Cities. The balance of about $3,265,000, or $1.25 per share, was paid by Cities exclusively to the public class A stockholders, in settlement of the separate claims asserted against Cities on behalf of

the Class A stockholders as such (R. 62a, 50-51).[2] It is this aspect of the plan to which the petition herein is directed.

The facts upon which the Class A claims are based are discussed at length in the Commission's findings (R. 62a, 33-42, 46-51) and are summarized in the opinion of the district court (R. 5a, 2-3). It appears that in March 1929 Arkansas-Natural authorized the issuance of 4,000,000 shares of the Class A stock. In May of that year about 1,021,000 shares of this stock was sold by Arkansas-Natural to holders of the common stock on a rights offering at $4 per share.[3] Later in that month Cities began a market manipulation through which 2,500,000 additional shares of Class A stock were distributed to the public. Through heavy trading on the New York Curb Exchange, with purchases vastly exceeding sales, the quoted prices of the class A common stocks were greatly inflated, and the Class A stock was distributed to the public at these manipulated prices. Arkansas-Natural received about $21,450,000 for the 2,500,000 shares of this stock, or approximately $8.58 per share, and the Class A stockholders paid some $13,000,000—or over $5 per share—more than the amount received by Arkansas-Natural, the excess representing the cost of the

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[2] Excluded from participation in the settlement are those who along with Cities shared the responsibility for the organization, initial financing, and subsequent management of Arkansas-Natural.

[3] Arkansas-Natural had been organized in April 1928 and all of its common stock was issued at that time, with Cities acquiring 60% thereof (R. 5a, 2).

marketing operations, including the manipulative activities. Principally as a result of these operations, the book value of the Arkansas-Natural common stock was increased from $2.40 per share as of December 31, 1928, to $4.34 per share as of December 31, 1930, when the distribution of the class A stock ceased.

On the basis of the record the Commission found that the market prices paid by the purchasers of the Class A stock "were artificially inflated as a result of Cities' activities, which involved fraudulent misrepresentation and omissions and a manipulation of the market which would have been actionable under general legal principles," and that "such sale of Class A stock to the public constituted a breach of fiduciary duty to the purchasers as a class requiring equitable readjustment in this reorganization" (R. 62a, 48-49). The Commission concluded that the payment by Cities of $1.25 per share, or a total of about $3,265,000, was a fair settlement of the claims of the Class A stock (R. 62a, 50-51). The district court, which approved and enforced the plan, agreed with the Commission's determinations (R. 5a, 6-7). The Court of Appeals affirmed (R. 67a-68a).

ARGUMENT

Petitioners do not here, and did not in the court below, contend that the plan failed to accord the full equitable equivalent of the rights of the public common stockholders of Arkansas-Natural, including a fair settlement of the corporate claims of Arkansas-Natural against Cities (Pet. 10). They

urge only that the public Class A stockholders had no valid basis for additional compensation at the expense of Cities and that Cities' undertaking in the plan to pay to the Class A stock by way of settlement something more than was paid to the common stock somehow or other violated the contractual rights of the public common stockholders.

The plan gives full recognition to the contractual rights of the common and Class A stocks in that parity treatment is accorded to both classes of stock in the assets and earnings of Arkansas-Natural. As noted above, under the plan the common stocks of Arkansas-Louisiana and of Arkansas-Fuel have been distributed pro rata to both classes of stock. Identical treatment is also accorded to the public common and Class A stockholders in regard to the payment by Cities of 25¢ per share in settlement of all corporate and derivative claims for wrongs allegedly committed by Cities against Arkansas-Natural. Petitioner did not question below, and does not question here, the adequacy of the settlement of these claims.

The settlement, under which the public holders of the Class A stock received $1.25 per share, was based upon separate claims against Cities asserted on behalf of the class A stockholders as such, and since this payment was made by Cities itself, and not out of the assets of Arkansas-Natural, it does not in any way reduce the participation of the public common stockholders in the assets of their corporation. In relation to the claims asserted by the Class A stockholders against Cities, petitioners

herein as representatives of the common stockholders do not have, as stated by the court below, "any more standing to complain than would any stranger on the street who read about the litigation and disapproved the result" (R. 68a).

Petitioners further contend that the initial purchasers of Class A stock did not have a class claim against Cities and that in any event no right of action by the original purchasers passed to their transferees (Pet. 25-30). Petitioners also question whether any fiduciary duty was violated by Cities to the purchasers of the class A stock (Pet. 19-22). These issues were properly raised by Cities and the contrary was asserted by the Class A stockholders (R. 62a, 41). The decision by Cities not to press these contentions, but rather to settle the claims asserted against Cities on behalf of the public Class A stockholders, is of no legitimate concern to petitioners.

Further, the mere fact that defenses might have been asserted by Cities against the claims of the Class A stockholders does not preclude approval of the settlement. In approving the settlement neither the Commission nor the district court was required to adjudicate the merits of any of the contentions for or against the claims asserted. As noted by the Commission, the activities of Cities give rise to actionable claims (R. 62a, 48); and it appears that a "spurious class action" on the basis of such claims could now be maintained in the federal courts, *Zahn* v. *Transamerica Corp.*, 162 F. 2d 36, 49-50 (C.A. 3); *Oppenheimer* v. *F. J. Young & Co.*, 144 F. 2d 387

(C.A. 2). Nor is it by any means settled law that successors to the original purchasers of the Class A stock were precluded from bringing suit as transferees of such stock. *Cf. Phelan* v. *Middle States Oil Corp.*, 154 F. 2d 978, 999-1002 (C.A. 2). Moreover, in a proceeding under Section 11(e), in which the Commission is exercising, subject to court review, powers and duties analogous to the equitable jurisdiction of a bankruptcy court, it is the duty of the reorganization tribunal to adopt an appropriate equitable remedy for misconduct by the controlling stockholder. *Cf. Pepper v. Litton*, 308 U.S. 295, 304; *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U.S. 138, 146. The settlement of such claims, rather than litigation on the merits, is an appropriate equitable remedy. *In re Electric Power & Light Corp.*, 176 F. 2d 687 (C.A. 2). On appeal, the only issue was whether the settlement was unfair to the public common stockholders of Arkansas-Natural. These stockholders, as we have seen, were not injured by Cities' distribution of the Class A stock, and as the payment under the settlement was made by Cities out of its corporate funds, the plan affected no rights of the stockholders whose interest petitioners represent.

CONCLUSION

The petition for a writ of certiorari asserts no conflict of decision and is devoid of merit. Accordingly it should be denied.

Respectfully submitted,

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OCTOBER TERM 1953

DOCKET NO. 275

PUBLIC COMMON STOCKHOLDERS' PROTECTIVE COMMITTEE OF ARKANSAS NATURAL GAS CORPORATION,

Petitioners,

v.

SECURITIES & EXCHANGE COMMISSION, CITIES SERVICE COMPANY, ARKANSAS NATURAL GAS CORPORATION, ARKANSAS LOUISIANA GAS COMPANY, ARKANSAS FUEL OIL COMPANY, CLASS A COMMON STOCK COMMITTEE,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF OF PETITIONERS, PUBLIC COMMON STOCKHOLDERS' PROTECTIVE COMMITTEE OF ARKANSAS NATURAL GAS CORPORATION

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Supreme Court of the United States

OCTOBER TERM 1953

DOCKET NO. 275

IN THE MATTER

of

ARKANSAS NATURAL GAS CORPORATION, CITIES SERVICE COMPANY, ARKANSAS LOUISIANA GAS COMPANY, ARKANSAS FUEL OIL COMPANY.

PUBLIC COMMON STOCKHOLDERS' PROTECTIVE COMMITTEE,

Petitioners.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The two principal arguments advanced in the respondents' briefs here are that the Arknat Common Stockholders are not aggrieved parties and in any event can recover or gain nothing on this appeal. If this were a simple case of two equal heirs of an estate, the only asset of which was a claim or claims against an insurance company, and the latter had contrived with one of the heirs to pay him a large additional amount on the side on the purported basis of a legally fictitious claim asserted by him individually, any arguments that the first heir had received his "full aliquot share of the estate" and therefore had no interest in the side payment and was without legal remedy would receive the scorn they deserve.

When the analogous situation arises in a so-called corporate reorganization the realities seem to be obscured by the number of individuals involved, the real and im-

aginary complexities of the corporate form or forms and perhaps most by the obfuscating terminology which characterizes those proceedings.

If the alleged individual claim of the Class A stockholders in Arknat or of the preferred heir in the analagous situation mentioned above has some legally recognizable basis, then Cities here or the insurance company there could make the side payment and plausibly argue that the common stockholders or the other equal heir, as the case may be, had no interest in it and had received their or his "full aliquot share of the estate." Without however, some such legal basis for the alleged separate individual claim, the side payment becomes a fraud on the other party entitled to share equally and the party defrauded accordingly has an interest in it and is entitled to damages in conpensation.

Taking up the briefs of the three respondents in order, the following statements and citations therein seem to us to require correction and comment:

Brief for Respondent Cities Service Company

Page 2: It is here stated that a holding to the effect that the claim of the Class A stockholders was invalid and that the payment of an extra $1.25 per share to them was a windfall "would not entitle the complaining stockholders to receive any more than they have already received under the plan." We submit that that statement is erroneous, for if the Class A stockholders and Common stockholders are entitled as a matter of law to equal treatment, and if they have not received it and the Class A stockholders have received a preferential payment on an illegal basis, then the Common stockholders are entitled either (a) to a redistribution of that sum equally among the Class A and Common stock-

holders, or (b) if such redistribution is impossible because of Cities' voluntary action in proceeding with the payment despite this appeal, to have Cities compelled to make a similar per share payment to the Common stockholders.

The second question posed by Cities as to whether the Commission had authority to approve the settlement of claims is particularly specious here. We have repeatedly said that we did not question the Commission's authority to approve a settlement of claims generally, but that there must be some valid legal basis for the claims so settled. They must not be fictitious or patently illegal, *because if they are the Commission's authority to settle claims becomes merely a guise and a technique for achieving an illegal preference among stockholders of equal rights.*

Page 5: The recital here as to Cities' alleged offer "to compromise all claims by payment of $1.50 per share to public holders of Class A Stock and 25¢ per share to public holders of Common Stock" and the contentions of the Class A and Common stock committee regarding the same, no doubt understandably omits reference to Cities own strong opposition before the Commission to the alleged class claim of the Class A stockholders.

Page 6: It is stated that "since no stay was obtained" etc., Cities consummated the plan and went ahead with the preferential payment to the Class A stockholders, which is the subject matter of this appeal. We submit that in so doing Cities proceeded at its own risk and that if the payment in question violated the rights of the Common stockholders to equal treatment with

the Class A stockholders, that violation can now only be corrected by payment of the same amount to the Common stockholders since Cities has itself made redistribution of the amount paid to the A stock impossible. The Common stockholders' rights were certainly not foreclosed, affected or impaired because Cities chose to go ahead with the disparate payment to the A stockholders despite the pending appeal. Annexed hereto as Exhibit A is a copy of the stipulation secured by the Common stockholders' committee to prevent any prejudice to the rights of the Common stockholders on this appeal by virtue of the accompanying statements sent by Cities to Arknat stockholders with the checks in payment of the amounts awarded under the plan.

Page 7: The statement is here made that the Common stockholders' "only contention is that the A stock should not have been paid anything in settlement of the class claim." Such is not "their only contention", and such statement evades the whole question here presented. Their contention is that they were and are entitled to equal treatment with the Class A stock in this reorganization and that where an additional payment has been made to the A stock on an illegal basis, then an equal amount must be paid to the Common stock. In other words the question is not so much with regard to Cities' right to pay the A stock as it is the right to pay them without paying an equal amount to the Common for the reason that discrimination accomplished by the payment of a fictitious class claim is still discrimination.

Page 8: The statement that the Common stock is not injured or aggrieved by the preferential pay-

ment to the A stockholders has already been answered above.

The statement that the principle that stockholders with the same contract rights are entitled to ratable distribution of the assets of the enterprise "was in no way violated here" *is true only if the payment paid to the Class A stockholders was on account of a bona fide and legally recognizable separate individual class claim.* If, as we contend, it was not, then the attempted separation of the corporate claims and the individual Class A claims becomes nothing but a specious device for a preferential payment to the A stockholders and a fraud on the Common stockholders.

Page 9: It is asserted that the validity or invalidity of the Class A stockholders' claim was completely irrelevant to the merit or lack of merit of the corporate claims and since the Common stockholders have not appealed the settlement of the corporate claims, they have no standing to question the Commission's findings as to the A stockholders' alleged class claim.

As we have repeatedly said, we think that the Commission's findings as to the corporate claims was unfair and inadequate and unduly influenced by its collateral position with respect to the class claim of the A stockholders. However, the corporate claims did have a valid legal existence and merit and in our opinion the cases hold that the Commission's finding thereon are final and not appealable unless there is some mistake of law. But by the same token its findings as to the alleged class claim of the A stockholders is in our opinion invalid *as a matter of law.* If it had some valid legal basis, then as respondents assert it would be

irrelevant as far as the corporate claims are concerned, but if it has not, then, as we have said repeatedly before, it becomes nothing but a technique and device for achieving an unequal payment to the A stockholders in derogation if not in actual fraud of the Common stockholders' right to equal treatment.

Page 9: Cities now endeavors to persuade this Court, as it has persuaded the Courts below, that its offer of $1.25 per share additional to the Class A stock was a *bona fide* offer in settlement of the alleged class claim by the Class A stockholders. That it was not and that the payment was initially dictated by the Commission is sufficiently established by the opposition of Cities to this feature of the plan in its briefs before the Commission* and the testi-

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* Cities' brief, April 2, 1953 before S. E. C., pp. 28-9, 32-3:

"As of December 1, 1951 only approximately 13.6% of the publicly-held A Stock was still held by persons (including executors and administrators) who acquired them during the entire 1929-1930 period that the A Stock was being marketed, and only 5.89% of the publicly-held A Stock was still held by persons (including executors and administrators) who acquired them during the June-September period when the prices are alleged to have been inflated (C. S. Exh. 30).

"The law is well-settled that rights of action for rescission or damages do not pass with the shares to subsequent purchasers, or donees. The law on this point was carefully considered and established by the courts in one phase of the reorganization of the Associated Gas and Electric system usually referred to as the "CDC Litigation".

* * * * * *

"Although the courts in the *Associated* case were particularly concerned with New York law, the law of other states is the same. See *Huston* v. *Ohio & Colorado Smelting & Refining Co.*, 63 Colo. 152, 165 Pac. 251 and *Schwartz* v. *Durham*, 52 Ariz. 256, 80 Pac. 2d 453.

* * * * * *

"The foregoing demonstrates that the large majority of holders of A Stock who in fact have a profit on their acquisition and no shadow of a claim, cannot, in order to obtain a further and purely windfall profit, hide under the skirts of the small minority who conceivably might have a claim."

mony of its officers referred to at pages 23-4-5 of our brief in support of the petition for certiorari herein.

Page 11: The above references sufficiently disprove the statement made on page 11 of Cities' brief that "After it made the offer, Cities of course did its best to get the offer approved; * * *".

Page 13: It is here stated "But neither principle, precedent nor sound administrative practice required it [Cities] to conduct war to the uttermost". With that we could agree, but there had to be some legally recognizable basis for the claim before it could be given the unique treatment it received. If it had been mingled with other claims which were valid, then it might rest on the basis of an overall settlement, but such is not the situation here. It was the single claim on the basis of which the alleged settlement with the Class A stockholders was made and unless it had some legal validity, the purported "settlement" becomes in fact a gratuity and windfall to the Class A stockholders, and irrespective of their deserts, a violation of the Common Stockholders' right to equal treatment.

The same comment applies with equal force to the statement of the Commission, here quoted by Cities, that "we are not called upon to adjudicate the merits of or to assign a specific monetary value to each particular claim". The abuse to which that rule of convenience is subject is demonstrated in the instant case. Whatever excuse the rule might have where various claims, some valid, some not valid, are involved, it fails when there is a single claim which any honest appraisal would reveal has no legal merit whatever.

Page 14: Cities says that the cases cited by petitioners are not in point because they involved decisions by the Commission "based on erroneous determinations of settled judicial doctrines". *We submit that that is precisely the situation here,* and although the Commission's determinations as to facts may be beyond appeal, its erroneous determinations of law are not. It is those and only those which we ask this Court to review here.

Brief for Respondent Class A Common Stock Committee

Page 2: Question 1 posed by these respondents is erroneous in that it begs the whole question involved here by asserting that the Common stock "has received full parity treatment in the distribution of the assets" of Arknat. It is only superficially true that the sum allocated by the Commission and by Cities to derivative corporate claims against it has been equally and ratably distributed among the Class A and the Common stockholders. But a far larger sum was allocated by them to a so-called individual class claim of the A stockholders, giving them $1.25 per share more than the Common stockholders. *This, we submit, could not legally be done unless there was some legally recognizable basis for the alleged class claim of the A stockholders.* If the Commission was desirous of punishing Cities and the latter had agreed to pay $4,000,000 to obtain a release from all stockholders, the same ratable distribution could have been accomplished by dividing the fund among all stockholders.

Question 2 is similarly erroneous in its assertion that petitioners "cannot benefit" from this appeal. Cities proceeded with the disparate payment of $1.25 per share extra to the A stockholders despite the pending appeal from that feature of the plan. Cities could not thereby foreclose or change the Common stockholders' rights. If Cities by its action has made it impossible for it to recover back that payment, which is presumably impracticable if not impossible, then it can only right the wrong by payment of an equal amount to the Common stockholders. We do not think the law is so without recourse or resource that the injury brazenly done the Common stockholders must now go uncompensated.

Page 3: The argument here again made that the public Common stockholders have received their full share because the amount allocated to the corporate claims of Arknat was equally distributed among them and the Class A stockholders and that petitioners have not appealed from the determination of the Commission regarding the corporate claims is subject to the same answer made above to the similar arguments advanced in Cities' brief. As we understand the cases, the Commission's determinations as to the facts cannot successfully be appealed from but we have the temerity to hope that its erroneous determination with regard to the law on which it bases its special award to Class A stockholders can be.

Page 4: The outline of facts here presented omits the fact that the first million shares of Class A stock or over ¼ of the total outstanding was initially issued and sold to the Common stock-

holders at $4.00 per share, and that no possible claim as to inflated prices or market manipulation can be made with regard to this 25% portion of the Class A stock.

The statement as to the market rigging operation also omits reference to the fact that the Common stock prices were similarly inflated along with those of the Class A stock, and *any Common stockholders who purchased their stock on the public market during that period suffered individually exactly the same injury from Cities that a Class A stockholder suffered.*

It is stated that Cities' market manipulation benefited the Public Common stockholders. As a matter of law that would be totally irrelevant to the issues here (*S. E. C.* v. *Central-Illinois Corp.*, 339 U. S. 96, 152), but the statement itself is contrary to the fact. The benefit, if any, to the Common stockholders was very small. The Common stock itself at all times sold on the market at prices equal to or higher than the Class A stock. In so far as such prices were inflated, the individual Common stock purchaser suffered the same injury as the purchaser of Class A stock, and as the figures in the exhibits before the Commission demonstrated, a large part of the inflated sums initially realized by Cities in this market operation were used up by it in subsequent support of the market by Cities. Much has been made by the Class A stockholders and by the Commission of this purported difference in equity capital contributions by the two classes of stock, but the cases to date rule out any such basis of allocation between stockholders in a corporate reorganization. Presumably the possibilities for conjecture and discrimination are too great to

allow any such basis for determination of the relative rights of stockholders in a corporate enterprise. (*Jackson* v. *White*, 188 Fed. 775, 779 (C. A. 4, 1911); *White* v. *Wogamon*, 47 Ariz. 195, 54 Pac. (2d) 793 (1936); *Standard Gas & Electric Co.* v. *Deep Rock Oil Corp.*, 117 Fed. (2d) 615 (C. A. 10, 1941), cert. den. 313 U. S. 564; *In re North American Light & Power Co.* (1947), H. C. Rel. 7514.

Page 5: Cases here cited by respondents afford no authority whatever for the proposition that "recognition must be accorded the fact that, at the expense of the Class A interest, Cities had fraudulently procured an inflated equity interest in Arknat".

Both *Taylor* v. *Standard Gas and Electric Co.*, 306 U. S. 307, and *Pepper* v. *Litton*, 308 U. S. 295, deal with the subordination of the claims of majority and controlling stockholders in the subject corporation in favor of minority public stockholders and creditors, whose claims in each case are wholly derivative and based on violations of fiduciary duty. Neither deals in any way with the claims or rights of public stockholders against a parent corporation for fraud or misrepresentations in the sale of stock to individuals under varying circumstances, which is a wholly different situation. Such claims are individual, not derivative, and involve no breach of fiduciary duty on the part of the seller. This basic distinction between these cited cases and the instant situation, respondents appear unable or unwilling to grasp.

Page 6: Here again question "1" posed by the respondents begs and avoids the issue by claiming that the Public Common stockholders received "parity treatment in the distribution of the

assets of Arknat". They received their equal share of that part of the claims award which was allocated only as a matter of form to the derivative corporate claims, but they did not receive the equal treatment which they are legally entitled to have with all other stockholders of equal right unless the additional amount paid to the Class A stockholders was paid on a *bona fide* claim by them. By so much *"whether or not that claim had merit" becomes the basic issue here, because whether it did have such merit determines whether the Common stockholders have or have not received the equal treatment to which they are entitled as a matter of law.*

Question "2" presented by respondents here does not make it clear what "settlement payment" is referred to, but presumably reference is made to the 25¢ per share payment on account of the so-called corporate derivative claims since it is stated that "no party affected thereby has appealed". Our reasons for not attacking that here are sufficiently set forth above in answer to the Cities' brief. That payment may be "moot" as respondents assert, but not the payment of $1.25 per share additional of the A stock, although Cities presumably hoped to make it so by proceeding with the payment despite this appeal.

Page 7: The specious argument here repeated that the "Common stock of Arknat has received its full aliquot interest in the assets of the corporation", and that it accordingly has no interest in the side payment to the A stockholders has already been answered above.

Respondents completely miss the point of this appeal if they think as here stated that "peti-

tioner does not contend that the Common stockholders are entitled to more''. On the contrary, we do contend that the Common stockholders are entitled to more—on the simple legal principle that stockholders of equal right are entitled to equal treatment and cannot be denied that on legally fictitious grounds; in other words they are entitled to precisely the same amount as the Class A stockholders, unless some valid legal basis can be found for the additional payment to the latter. And that, we submit, does not exist.

It is further stated that if the claim asserted by the Class A stockholders is without merit, that still leaves the Common stockholders without any basis for complaint. That is of course what the Commission, Cities and the Class A stockholders' committee hoped to achieve by this very clever, arbitrary and artificial division of 25¢ to all stockholders on account of the corporate claims and $1.25 per share extra to the Class A stock on account of their alleged class claim against Cities for the alleged market manipulation. If the Class A claim had no merit, then there was no legal basis for the unequal treatment of the two classes of stock and Cities having proceeded despite the pending appeal with this unequal payment to the Class A stockholders can now only redress the wrong by a similar payment to the Common stockholders.

The Common stockholders are aggrieved because they have not received the equal treatment to which they are by law and contract entitled.

Hooker v. *Burr*, 194 U. S. 415, 419, here cited and quoted by respondents is wholly inapposite.

That case dealt with a question of the constitutionality of a state statute changing the right of redemption after foreclosure of real property. Appellant was the purchaser at the foreclosure sale, not claiming under either the mortgagor or mortgagee, and his interest was accordingly held too remote.

Page 8: We think that only the incredibly naive will believe that Cities would not have been willing to pay on the corporate claims any amount that it did not have to pay on account of the alleged class claim of the Class A stockholders. We submit that this goes considerably beyond mere conjecture and is amply supported by the statement of the officers of Cities itself in cross examination (see pages 23-4-5 of our main brief herein), but whether such would or might have been the case is beside the point on this appeal. Our appeal here rests on no such conjecture. The Common stockholders do not seek more on conjectural grounds that more would have been paid on the corporate claim if less had been paid on the alleged Class A separate class claim of the stockholders, but the Common stockholders do seek more on the simple legal principle that they are entitled to and should receive the same amount paid to the Class A stockholders, unless some legally adequate reason can be advanced, as none has been to date, for the separate payment to them.

Page 9: The quotation from *Doremus* v. *Board of Education*, 342 U. S. 429, 432, that "* * * this Court does not sit to decide arguments after events have put them to rest" is apposite only as indicating respondents' wishful thinking. They no doubt hoped to achieve such result by proceeding with the payments under the plan

despite this appeal, but fortunately for petitioners such is not yet the fact.

The reference to Mr. Justice Holmes' phrase "disinterested malevolence" in his opinion in *American Bank & Trust Company, et al.* v. *Federal Reserve Bank of Atlanta, Georgia, et al.*, 256 U. S. 350, 358 (1921), is interesting because there as here it was shown on the part of the appellees, not the appellants, and contrary to respondents' assertion here, Justice Holmes there held it did have a place in appellate procedure and could be recognized and redressed as such. The Reserve Bank under its right to collect and clear checks for payment claimed the right to hold them and present them to the drawee banks in such embarrassingly large quantities as to drive them out of business or into the Reserve system. He rejected that sophistry and held the injury thus intended and effected was none the less actionable because accomplished under otherwise legal right. By the same token, respondents here claim that because the Common stockholders have received their proper share of the amount allocated to corporate derivative claims, the diversion of a far larger amount to the Class A stock through an alleged separate class claim settlement is thereby put beyond the scrutiny of this Court. *Similar perception here will show that the injury to the Common stockholders is none the less real because of the outer, and admittedly clever, legal form by which it has been accomplished.*

The statement at the bottom of this page that "it has been finally adjudicated that the common stock has received everything to which it is entitled" is simply not true. There has been

no such final adjudication yet. If, as we submit, the Common stockholders are entitled as a matter of law to equal treatment with other stockholders of equal right, this Court has full right and power to so decree.

Page 10: It is true that if the alleged separate settlement payment by Cities to the Class A stock "could have been negated" the A stock would have received less, and both it and the Common would have merely shared equally and pro rata in the derivative claims settlement. But such is not the situation now presented. The additional separate payment to the Class A stockholders has been made *and unless it was made on some valid legal basis, the Common by virtue of its right to equal treatment is entitled to the same amount.*

It is stated that "Petitioner misconceives the judicial function". The misconception is apparently on the part of these respondents, other than the Commission itself which in its brief (p. 9) concedes the Court's right of review here. The three cases here cited and quoted by respondents are not remotely applicable. In *C. & S. Airlines* v. *Waterman Corp.*, 333 U. S. 103 (1947), this Court refused to review an order of the Civil Aeronautics Board approved by the president as outside its jurisdiction; *Amalgamated Asso.* v. *Wisconsin Emp. Rel. Bd.*, 340 U. S. 416, involved a question of review of a judgment of the Wisconsin Court upholding an arbitrator's award which had been superseded by agreement and time of performance of which had elapsed; and *Colman* v. *Miller*, 307 U. S. 433, concerned this Court's right of review of state action in ratifying an amendment to the Federal Constitution.

The applicable law as to this Court's right and duty to review here is succinctly stated by Mr. Justice Frankfurter in *S. E. C.* v. *Chenery Corp, et al.*, 318 U. S. 80, 87, 89-90 and likewise in *S. E. C.* v. *Cogan*, 201 Fed. (2d) 78, 85, cited and quoted at pages 17 and 18 of our main brief herein.

Brief for The Securities and Exchange Commission

Page 5: The statement of facts here mentions that through Cities' market manipulations "the quoted prices of the class A common stocks were greatly inflated", but it should also be stated that the quoted prices of the common stock were likewise inflated (see our main brief, pp. 5, 6).

Page 7: The argument that the "plan gives full recognition to the contractual rights of the common and Class A stocks in that parity treatment is accorded to both classes of stock in the assets and earnings of Arkansas-Natural" has already been fully dealt with above in answer to similar arguments in the Cities' and Class A Committee's briefs.

Page 8: It is here stated that "the mere fact that defenses might have been asserted by Cities against the claims of the Class A stockholders does not preclude approval of the settlement". With that statement we have no quarrel. But that, we submit, is not the question here. The basic question is whether the Class A stockholders, over 85% of whom are transferees of the original purchasers of said stock during the period of Cities' alleged market manipulation in 1929 and 1930 (at prices from 8¾ to 24⅝)

can, as a matter of law, as such subsequent transferees have inherited any present claim against Cities in that regard.

Subsidiary to this are two other questions, (a) whether Cities in its sales of such Class A stock to the purchasers can be said to have breached any "fiduciary duty" to them, and (b) whether the Class A stockholders, independently of the plan of reorganization, could be said to have a "class" claim.

As to the former, we submit that Cities as vendor of the Class A stock could not be said to have stood in any fiduciary relationship with the purchasers thereof at the time of purchase (see our main brief herein, Point III, pp. 19-22).

As to the "class claim", two cases here cited by the Commission, namely, *Zahn* v. *Transamerica Corp.*, 162 F. (2d) 36, and *Oppenheimer* v. *F. J. Young & Co.*, 144 F. (2d) 387, confirm the position taken in our main brief (pp. 25-6-7) that at best only the original Class A stockholders who purchased their stock in 1929 and still retain it might be allowed to maintain a "spurious" class action under the federal rules of procedure. The difference between a true "class" action and a "spurious" class action as a procedural joinder device seems still to be ignored by the respondents. As Judge Augustus Hand states in his opinion in the *Oppenheimer* case (p. 390):

> "There can be no doubt that claimants who become parties to this class suit would, if successful, be entitled to a different measure of damages."

Page 9: Comparison is here invited with *Phelan* v. *Middle States Oil Corp.*, 154 Fed. (2d) 978, 999-

1002, as authority for the statement "Nor is it by any means settled law that successors to the original purchasers of the Class A stock were precluded from bringing suit as transferees of such stock". The *Phelan* case involved a question of the liability of a federal equity receiver to holders of bearer bonds. It seems obvious that their rights are in the nature of things derivative through the bankrupt estate as creditors and that any surcharge of the receiver would inure to the benefit of the estate and through it to their benefit as creditors. This case is cited in *Plitt* v. *Stonebraker*, 195 Fed. (2d) 39, 42, as authority for the proposition "One rule is that all security for payment of a promissory note follows the note and inures to the benefit of the holder of the note". The discussion in the *Phelan* case as to security transferee rights appears to be *dicta*, since Judge Frank introduces the discussion by referring to it as "Another argument based upon New York decisions (not suggested here or in the Court below by appellees)".

We submit that the statement of the law in that regard, as set forth in our main brief (pp. 27-8-9), that a bare transfer of stock does not in the absence of special assignment carry with it any right of action for damages caused by false representations made to the original purchaser has not been, and we think cannot be, successfully controverted either as a matter of New York law or general law.

We have already dealt in our main brief (pp. 21-2) with the misapplication and perversion of the fiduciary duty principle laid down in *Pepper* v. *Litton*, 308 U. S. 295, 304 and

American United Mutual Life Insurance Co. v. *City of Avon Park,* 311 U. S. 138, 146, which the Commission here again cites and relies on as validating its finding of liability by Cities to the Class A stockholders.

In re Electric Power & Light Corp., 176 Fed. (2d) 687, is cited as authority for the statement that "the settlement of such claims, rather than litigation on the merits, is an appropriate equitable remedy". With that abstract statement we have no quarrel but the proposition and the case cited do not meet the issue here. In that case the claims settled were derivative in nature and had some at least arguable legal basis. The claims of the Class A stockholders here have neither of these characteristics.

Page 10: The conclusion of the Commission that "The petition for writ of certiorari asserts no conflict of decision" is erroneous. As shown here and in our main brief, there is "conflict of decision" in the following three areas here:

(a) The fiduciary duty principle as enunciated by this Court in *Pepper* v. *Litton,* 308 U. S. 295, and *American United Mutual Life Ins. Co.* v. *City of Avon Park,* 311 U. S. 138, is misapplied and distorted in the Findings and Opinion of the S. E. C. here as it was in *S. E. C.* v. *Chenery Corp.,* 318 U. S. 80.

(b) The additional payment to the Class A stockholders rests on the premise that the over 85% of the present holders who are transferees of the original purchasers inherited the latters' rights of action for fraud and misrepresentation against Cities—contrary to established law

(our main brief, pp. 27-30), and contrary to the decision of the Commission itself *In the Matter of Stanley Clarke, Trustee of Associated Gas & Electric Co.*, H. C. Rel. 4985, p. 45 (1944); *In re Associated Gas & Elec. Co.*, 53 F. Supp. 107, 112, aff'd *sub. nom. Elias* v. *Clarke*, 143 F. 2d) 641;

(c) The inclusion and settlement in the instant plan of reorganization of personal, non-derivative claims of stockholders is contrary to the previously established practice of the Commission, if not in fact outside its jurisdiction. *Matter of Columbia Gas & Electric Corp., et al.*, H. C. Rel. 3885, p. 25 (1942).

CONCLUSION

For the reasons stated above and in our main brief herein the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Exhibit A

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Docket No. 11041

STIPULATION

In the Matter of

ARKANSAS NATURAL GAS CORPORATION
CITIES SERVICE COMPANY
ARKANSAS LOUISIANA GAS COMPANY
ARKANSAS FUEL OIL COMPANY

PUBLIC COMMON STOCKHOLDERS' PROTECTIVE COMMITTEE,

Appellants.

IT IS HEREBY STIPULATED AND AGREED by and among the undersigned that the application of the Public Common Stockholders' Protective Committee for a stay of the consummation, etc., of the amended plan of Arkansas Natural Gas Corporation is hereby withdrawn upon the express understanding and agreement by Cities Service Company and Arkansas Natural Gas Corporation that the letter of transmittal dated April 8, 1953 and the statement appearing on checks sent therewith to the stockholders shall be considered merely notice of the provisions of the amended plan and shall otherwise be without prejudice to the rights of said common stockholders or the Class A

stockholders in the pending appeal or any subsequent proceedings herein.

Dated: April 15, 1953.

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